In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 1190

J. STRICKLAND & CO., PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

In 1955, petitioner, which is in the business of manufacturing and selling cosmetics, purchased the inventory and manufacturing equipment of Newbro Manufacturing Company, which marketed similar products. At the same time Newbro purported to appoint petitioner its exclusive sales representative for five years (either party having an option to renew for three additional years), during which period petitioner was to have the exclusive use of Newbro's trademarks and trade names, and petitioner was to pay Newbro at least $35,700 per year. Simultaneously, Newbro granted the three individuals who controlled 97% of petitioner's stock an option to pur-

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chase the trademarks for $20,000 at the end of five years.

From 1956 through 1959, petitioner manufactured and marketed Newbro's products, and claimed that the amounts paid each year under the terms of the contract were deductible royalties under Section 162(a)(3) of the Internal Revenue Code of 1954. The district court held that in substance the transaction constituted royalty payments made pursuant to a licensing agreement and thus allowed petitioner's claimed deductions. The court of appeals reversed, concluding that the transaction was in substance a sale of the trademarks from Newbro to petitioner so that petitioner's annual payments constituted the purchase price of the trademarks and that the finding of the lower court to the contrary was clearly erroneous. (Pet. A2–A8.)

The decision of the court of appeals is correct, and there is no conflict of decisions or other basis for further review.

If form were the controlling factor, a taxpayer who was in fact acquiring virtually full ownership of an asset could deduct as "rental" or "royalty" payments amounts which actually represented the asset's purchase price. Consequently, in cases such as this one the courts have uniformly held that the tax incidence of the transaction turns on the economic realty of the transaction rather than the form in which it is clothed and thus that a document which is in form a "license" or "lease" may in fact be a sale. See *Oesterreich* v. *Commissioner*, 226

F. 2d 798 (C.A. 9); *Starr's Estate* v. *Commissioner*, 274 F. 2d 294 (C.A. 9); *Meiselman* v. *Commissioner*, 300 F. 2d 666 (C.A. 4); *Rotorite Corp.* v. *Commissioner*, 117 F. 2d 245 (C.A. 7); *Western Contracting Corp.* v. *Commissioner*, 271 F. 2d 694 (C.A. 8); *Benton* v. *Commissioner*, 197 F. 2d 745 (C.A. 5).[1]

Petitioner does not dispute this basic principle. Instead it merely argues that the court of appeals exceeded the limitations of its power of review under Rule 52(a) of the Federal Rules of Civil Procedure. *United States* v. *Gypsum Co.*, 333 U.S. 364; *Orvis* v. *Higgins*, 180 F. 2d 537, 539–540 (C.A. 2), certiorari denied, 340 U.S. 810; *Bishop* v. *United States*, 266 F. 2d 657 (C.A. 5).

Despite the language in which the parties couched the instant transaction, the court of appeals was fully justified in concluding that in substance virtually full ownership in the property was transferred to petitioner and that the substance of the transaction was a sale rather than license. The royalty was computed so that petitioner would pay at least $178,000 during the initial five years; this was well in excess of the

[1] Whenever the "practical effect" of an arrangement such as is here in question is to give the "licensee" either virtually full ownership of the property or an equity therein, the courts have treated the transaction as in substance a sale, regardless of the form of device used. See *Oesterreich* v. *Commissioner*, *supra*; *Starr's Estate* v. *Commissioner*, *supra*. Thus, it has been held that, where an agreement provides for unreasonably large periodic payments over a relatively short period of time, and the property can be purchased for a nominal amount at the end of the payment period, the transaction is in substance a sale. *Oesterreich* v. *Commissioner*, *supra*; *Haggard* v. *Commissioner*, 241 F. 2d 288 (C.A. 9).

price at which petitioner's witnesses admitted they could have purchased the trademarks in 1955. Thereafter, petitioner's shareholders had an option to obtain title to the trademarks for $20,000. From the inception of the contract it was practically certain that this option would be exercised in view of the fact that petitioner's alternative course of action was to pay an additional $35,700 per year during the three-year renewal period and then to lose its entire equity in the trademarks of at least $285,000. As the court of appeals noted, petitioner "was expending large sums in advertising and promoting the products covered by the trademarks," which "would be most unusual if the marks were to remain the property of Newbro" (Pet. A6). On this basis the court of appeals properly concluded that the real agreement between the parties was in substance a sale, although thinly disguised for tax purposes as a license, and that petitioner's payments constituted the purchase price of the trademarks rather than deductible royalty payments.

For the foregoing reasons the petition for certiorari should be denied.

Respectfully submitted.

THURGOOD MARSHALL,
Solicitor General.
MITCHELL ROGOVIN,
Assistant Attorney General.
DAVID O. WALTER,
ROBERT I. WAXMAN,
Attorneys.

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